

Agenda Item No.
EAST SUSSEX FIRE AUTHORITY

Date 13 June 2019

Title of Report Treasury Management – Stewardship Report for 2018/19

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Background Papers Prudential Code for Capital Finance 2004
 Local Government Act 2003
 Local Government Investments – Guidance
 CIPFA Prudential Code
 CIPFA Treasury Management in the Public Services- Code of Practice
 Local Government and Public Involvement in Health Act 2007
 Communities and Local Government-Changes to the Capital Finance System

East Sussex Fire Authority - 15 February 2018 – Agenda Item 29
 Treasury Management Strategy for 2018/19
 14 June 2018 – Agenda Item 46 Treasury Management – Stewardship report for 2017/18

Policy and Resources Panel - 1 November 2018 – Agenda Item No 109: Half yearly report for 2018/19

Appendices None

Implications

CORPORATE RISK		LEGAL	✓
ENVIRONMENTAL		POLICY	
FINANCIAL	✓	POLITICAL	
HEALTH & SAFETY		OTHER (please specify)	
HUMAN RESOURCES		CORE BRIEF	
EQUALITY IMPACT ASSESSMENT			

PURPOSE OF REPORT The Annual Treasury Management Stewardship Report is a requirement of the Fire Authority's reporting procedures and informs Members of Treasury Management performance for 2018/19 and compliance with Prudential Indicators.

EXECUTIVE SUMMARY The Fire Authority has complied with its approved Treasury Management Strategy and Prudential Indicators for the year.

The Bank of England (BoE) Base Rate was raised from 0.50% to 0.75% on the 2nd August 2018. In challenging economic conditions

the average rate of interest received through Treasury Management Activity was 0.80%. This reflected the Fire Authority's continuing prioritisation of security and liquidity over yield.

The Fire Authority is investigating options to invest a portion of core balances in longer duration funds to secure improved investment returns. Decisions on future investment will be taken in the context approved capital programme and the requirement to fund it over the medium term.

No new borrowing was undertaken in 2018/19 with total loan debt outstanding of £10.773m at 31st March 2019, the average interest rate was 4.60%. The next loan repayment is due on the 31st March 2021 (£75k) with the PWLB. There have been no beneficial opportunities to reschedule debt so far during the year. The projected outturn of the Fire Authority's Capital Financing Requirement (CFR), a measure of the underlying need to borrow is £10.773m.

RECOMMENDATIONS The Fire Authority is asked to note the Treasury Management Performance for 2018/19.

TREASURY MANAGEMENT-STEWARDSHIP REPORT FOR 2018/19

1 Introduction

- 1.1 The Fire Authority's treasury management activities are regulated by a variety of professional codes and statutes and guidance:
- a) The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
 - b) Statutory Instrument (SI) 3146 2003 develops the controls and powers within the Act;
 - c) The SI requires the Fire Authority to undertake any borrowing activity with regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities;
 - d) Under the Act the Ministry of Housing, Communities & Local Government (MHCLG) has issued Investment Guidance to structure and regulate the Authority's investment activities.
- 1.2 The Fire Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken on a prudent, affordable and sustainable basis and its treasury management practices demonstrate a low risk approach.
- 1.3 The Code requires the regular reporting of treasury management activities to:
- a) Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report);
 - b) Review actual activity for the preceding year (this report),
 - c) A mid year review and
 - d) A change in the Strategy (if and when required).
- 1.4 This report sets out:
- a) A summary of the strategy agreed for 2018/19 and the economic factors affecting the strategy in the year;
 - b) The Fire Authority's treasury activity during the year on borrowing and short term investments;
 - c) The Prudential Indicators which relate to the Treasury function and compliance with limits

2 2018/19

2.1 **Strategy for 2018/19**

- 2.1.1 At its meeting on 15 February 2018, the Fire Authority agreed its Treasury Management Strategy for 2018/19, taking into account the economic scene including forecast levels of interest rates. At the same time, the Treasury Management Policy Statement was agreed for 2018/19 as set out below.

- 2.1.2 East Sussex Fire Authority defines its treasury management activities as:
“The management of the organisation’s cash flows, its banking, money market and capital market transactions, the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

The Fire Authority regards the successful identification, monitoring and management of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

This Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

Borrowing

- 2.1.3 The Fire Authority at the beginning of 2018/19 did not expect to undertake any additional external borrowing in the next 12 months.
- 2.1.4 Opportunities to reschedule debt had been monitored but have not arisen as yet. The PWLB increased all of its lending rates in October 2010 by 1% on all rates. However, it did not increase the rate of interest used for repaying debt so that not only had the cost of our future borrowing increased but the opportunity to restructure our debt when market conditions allow has been significantly reduced.

Investment

- 2.1.5 When the strategy was agreed in February 2018, it emphasised the continued importance of taking account of the current and predicted future state of the financial sector. The Treasury Management advisors (Link Asset Services) commented on short term interest rates, the UK economy, inflation, the outlook for long term interest rates and these factors were taken into account when setting the strategy.
- 2.1.6 Additionally, the Authority makes use of the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:
- credit watches and credit outlooks from credit rating agencies;
 - credit default swap (CDS) spreads to give early warning of likely changes in credit ratings; and
 - sovereign ratings to select counterparties from only the most creditworthy countries.
- 2.1.7 The strategy going forward was to continue with the policy of ensuring minimum risk but was also intended to deliver secure investment income of at least bank rate on the Fire Authority’s cash balances.

2.1.8 As was clear from the events globally and nationally since 2008, it is impossible in practical terms to eliminate all credit risk. The Fire Authority seeks to be as prudent as possible.

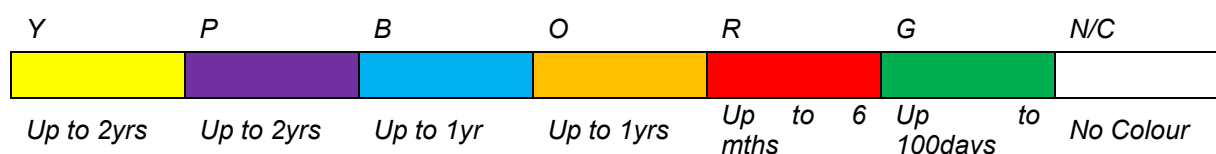
2.1.9 The strategy aimed to ensure that in the economic climate that a prudent approach was maintained. This would be achieved through investing with selected banks and funds which met the Authority's rating criteria. The emphasis would continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield. The strategy continued with this prudent approach.

2.1.10 It was also recognised that movements within the money markets happen with no notice and the Treasurer may have to amend this strategy in order to safeguard Fire Authority funds. As in the past any such actions would be reported to the next Fire Authority meeting.

2.1.11 The Fire Authority balances were to be invested in line with the following specific methodology:-

The modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative credit worthiness of counterparties. These colour codes are used by the Authority to determine the duration for investments. The strategy provides scope to invest in AAA rated foreign banks. However the Authority proposes to only use counterparties noted in the table below and within the following durational bands that are domiciled in the UK.

- Yellow 2 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour, not to be used



The Link Asset Services credit worthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue influence to just one agency's ratings.

Typically the minimum credit ratings criteria the Authority use, will be a short term rating (Fitch or equivalent) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings

but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use. All credit ratings will be monitored daily. The Authority is alerted to changes to ratings of all three agencies through its use of the Link Asset Services credit worthiness service.

- if a downgrade results in the counterparty or investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

The Link Asset Services methodology was revised in October 2013 and determines the maximum investment duration under the credit rating criteria. Key features of Link Asset Services credit rating policy are:

- a mathematical based scoring system is used taking ratings from all three credit rating agencies;
- negative and positive watches and outlooks used by the credit rating agencies form part of the input to determine a counterparty's time band (i.e. 3, 6, 9, 12 months etc.).
- CDS spreads are used in Link Asset Services creditworthiness service as it is accepted that credit rating agencies lag market events and thus do not provide investors with the most instantaneous and "up to date" picture of the credit quality of a particular institution. CDS spreads provide perceived market sentiment regarding the credit quality of an institution.
- After a score is generated from the inputs a maximum time limit (duration) is assigned and this is known as the Link Asset Services colour which is associated with a maximum suggested time boundary.

Counterparty List:

Counterparty	Country/ Domicile	Instrument	Maximum investments	Max. maturity period
Counterparties in UK				
Debt Management and Deposit Facilities (DMADF)	UK	Term Deposits	unlimited	1 yr
Government Treasury bills	UK	Term Deposits	unlimited	1 yr
Local Authorities	UK	Term Deposits	unlimited	1 yr
<i>RBS/NatWest Group</i> • <i>Royal Bank of Scotland</i> • <i>NatWest</i>	UK	Term Deposits (including callable deposits), Certificate of Deposits	£4m	1 yr
<i>Lloyds Banking Group</i> • <i>Lloyds Bank</i> • <i>Bank of Scotland</i>	UK		£4m	1 yr
<i>Barclays</i>	UK		£4m	1 yr
<i>Santander UK</i>	UK		£4m	1 yr
<i>HSBC</i>	UK		£4m	1 yr
Goldman Sachs IB	UK	Term Deposits	£4m	1 yr
Standard Chartered	UK	Term Deposits	£4m	1 yr
Individual Money Market Funds (MMF) CNAV and LVNAV	UK/Ireland/ domiciled	AAA rated Money Market Funds	£4m	Liquidity/ instant access
Enhanced Money Market / Cash Funds (EMMFs) VNAV	UK/Ireland/ EU domiciled	AAA Bond Fund Rating	£4m	Liquidity

2.1.12 All Money Market Funds used will be monitored and chosen by the size of the fund, rating agency recommendation, exposure to other Countries (Sovereign debt), weighted average maturity and weighted average life of fund investment and counterparty quality.

2.1.13 All of the investments held with the above counterparties will be classified as Specified Investments. These investments are sterling investments of not more than one-year maturity with institutions we deem to be high credit quality or with the UK Government (Debt Management Account Deposit Facility). These are considered low risk assets where the possibility of loss of principal or investment income is small.

2.1.14 Non Specified Investments are any other types of investment that are not defined as specified. The identification and rationale supporting the selection of these other investments are set out below:

Table 4	Minimum credit criteria	Period
Local Authorities	Government Backed	2 years
Mixed Asset Fund(s)	Appropriate rating	2 - 5 years
Pooled Property Fund(s)	N/A	5+ years

The maximum amount that can be invested will be monitored in relation to the Authority's surplus monies and the level of reserves, the limit will be £2.5m across all non specified investments. The approved counterparty list will be maintained by referring to an up-to-date credit rating agency reports, and the Authority will liaise regularly with brokers for updates. Counterparties may be added to or removed from the list only with the approval of the Treasurer.

2.2 The economy in 2018/19 – Commentary from Link Asset Services (Treasury Management Advisors) in April 2019.

2.2.1. After weak economic growth of only 0.2% in quarter one of 2018/19, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing country in the G7 in quarter 4.

2.2.2. The Monetary Policy Committee raised the Bank Rate from 0.5% to 0.75% in August 2018 and it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth.

2.2.3. Nevertheless, the MPC has been having increasing concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached.

2.2.4 CPI inflation has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

2.2.5 The major UK news event of the year was the ongoing arrangements for Brexit. The Conservative minority government was unable to muster a majority in the Commons over its Brexit deal. The EU deadline of April 12 for the House of Commons to propose what form of Brexit it would support was not met. The now extended deadline of the 31st October is the next key milestone in the Brexit process.

However the degree of disagreement within each of the two main political parties is probably now even greater than before the initial deadline; this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

2.3 Interest on short term balances

- 2.3.1. The total amount received in short term interest for the 2018/19 was £206,450 at an average rate of 0.80%, the average base rate for the year was 0.67%.
- 2.3.2. Full detail of the interest received has been set out in paragraph 3.7.4

2.4 Long term borrowing

- 2.4.1 No borrowing was undertaken in 2018/19. The total outstanding loan debt at 31 March 2019 was £10,773,000. There was no Loan Maturities in year and the average interest rate on external debt for the year was 4.60%.
- 2.4.2. No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

2.5 Short term borrowing

- 2.5.1 No borrowing was undertaken on a short-term basis during 2018/19 to date to cover temporary overdraft situations.

3 Prudential Indicators and limits relating to Treasury Management activities

3.1 The limits set for 2018/19

The Strategy Report for 2018/19 set self-imposed prudential indicators and limits. There are on an annual basis and monitored. They comprise:

- Authorised limit for borrowing (see 3.2 below)
- Interest rate exposure (see 3.3 below)
- Maturity structure of debt (see 3.4 below)
- Maturity structure of investments (see 3.5 below)
- Compliance with the treasury management code of practice (see 3.6 below)
- Interest on our investments (see 3.7 below)
- Capital Financing Requirement and Minimum Revenue Provision Statement (see 3.8 below)

None of the limits were exceeded in 2018/19.

3.2 Authorised limit for borrowing

- 3.2.1 The table below sets out the actual 2018/19, original estimate and actual in 2018/19 for borrowing.

	2017/18 Actual	2018/19 Original Estimate	2018/19 Actual
	£000	£000	£000
Opening CFR	10,973	10,773	10,773
Capital Investment	2,016	3,305	1,010
Sources of Finance	(1,777)	(2,874)	(579)
MRP	(439)	(431)	(431)
Movement in year	(200)	-	-
Closing CFR	10,773	10,773	10,773
less Finance Lease Liability	-	-	-
Underlying Requirement	10,773	10,773	10,773
Borrowing			
Actual Long Term Borrowing	10,773	10,773	10,773
Over / (Under) Borrowing	-	-	-
Operational Boundary	11,441	11,241	11,241
Authorised Limit	13,831	13,630	13,630

3.2.2 The outturn for 2018/19 shows no under or over borrowing.

3.2.3 The borrowing limits set in each year include capacity to borrow in advance of need.

3.2.4 The Operational boundary for borrowing was based on the same estimates as the Authorised limit. It reflected directly the authorised borrowing limit estimate without the additional amount for short term borrowing included to allow, for example, for unusual cash movements. The Operational boundary represents a key management tool for in year monitoring and long term borrowing control.

3.2.5 The Authorised limit was consistent with the Fire Authority's current commitments, existing plans and the proposals for capital expenditure and financing, and with its approved treasury management policy statement and practices. It was based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom (short term borrowing) over and above this to allow for day to day operational management, for example unusual cash movements or late receipt of income. Risk analysis and risk management strategies were taken into account as were plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

3.2.6. The Authorised limit is the "Affordable Borrowing Limit" required by S3 of the Local Government Act 2003 and must not be breached. The estimated long term borrowing at 31 March 2019 of £10,773,000 is under the Authorised limit set for 2018/19 of £13,630,000.

3.3 Interest rate exposure

3.3.1 The Fire Authority's Prudential Indicator continued the practice of seeking competitive fixed interest rate exposure for borrowing and lending.

	2018/19	2019/20	2020/21
Interest rate exposures	Upper	Upper	Upper
Limits on fixed interest rates based on net debt*	100%	100%	100%
Limits on variable interest rates based on net debt*	0%	0%	0%

*Net debt is borrowings less investments

3.4 Maturity structure of debt

3.4.1 The Fire Authority set upper and lower limits for the maturity structure of its borrowings as follows.

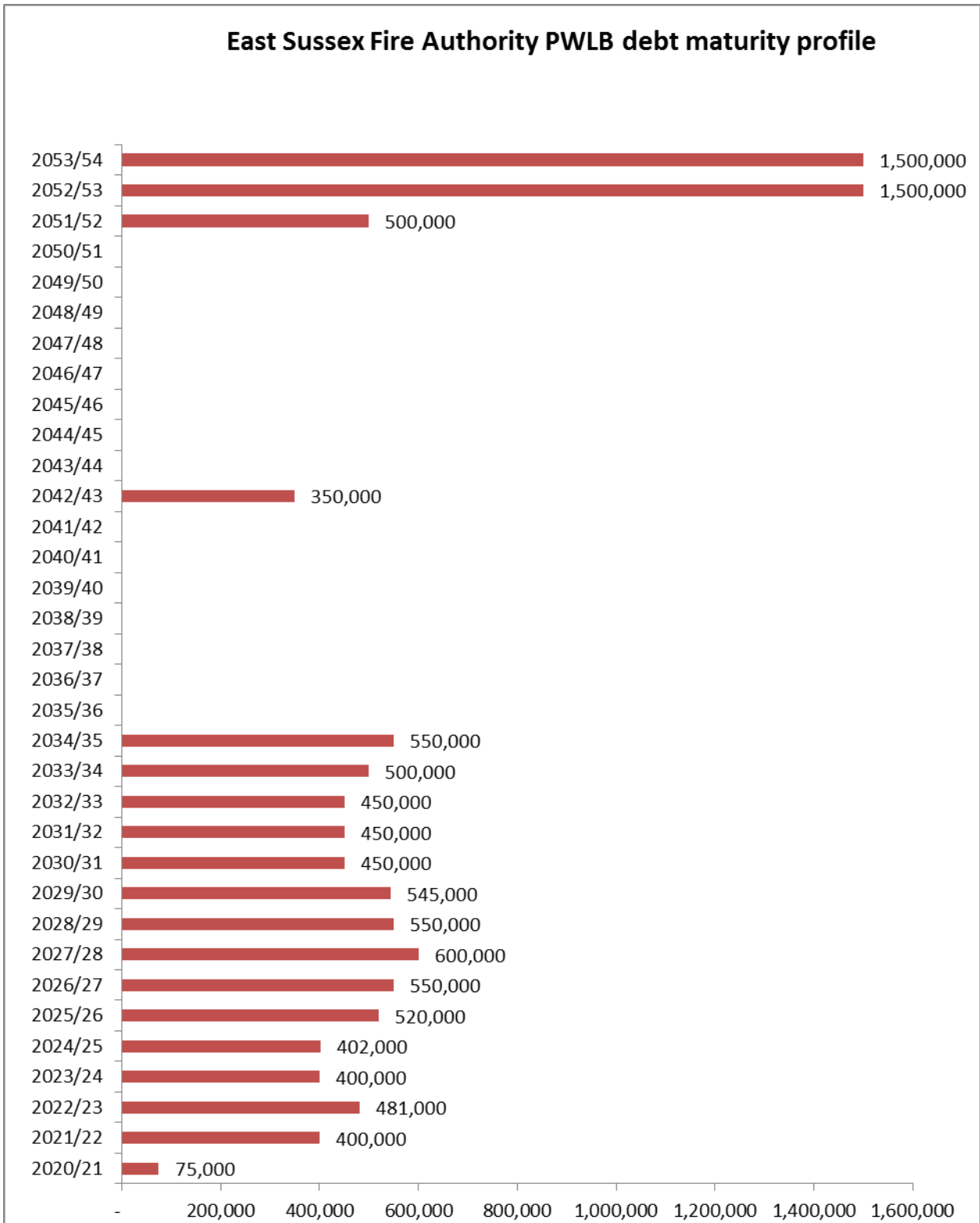
	<u>Lower Limit</u>	<u>Upper Limit</u>	<u>At 31 March 2019</u>
Under 12 months	0%	25%	0%
12 months and within 24 months	0%	40%	1%
24 months and within 5 years	0%	60%	12%
5 years and within 10 years	0%	80%	24%
10 years and within 20 years	0%	80%	27%
20 years and within 30 years	0%	80%	3%
30 years and within 40 years	0%	80%	33%
Over 40 years	0%	80%	0%

3.4.2 Any new borrowing undertaken would give due consideration to the debt maturity profile, ensuring that an acceptable amount of debt is due to mature in any one financial year. This helps to minimise the authority's exposure to the risk of having to replace a large amount of debt in any future years when interest rates may be unfavourable.

3.4.3 No new borrowing was undertaken in 2018/19. The following graph shows the majority of debt matures in the next 10 to 20 years with some longer dated maturities out to 2053/54. The next loan to be repaid will be on the 31 March 2021 (£75,000).

3.4.4 PWLB Debt Maturity Profile

East Sussex Fire Authority PWLB debt maturity profile



3.5 Maturity Structure of Investments

3.5.1 The limits below are deemed prudent and will be reviewed in future years.

Principle sums invested for periods longer than 365 days			
	2018/19 £m	2019/20 £m	2020/21 £m
Limit	2.50	2.50	2.50

3.6 Compliance with the Treasury Management Code of Practice

East Sussex Fire Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

3.7 Interest on Investments

3.7.1 Base interest rates were increased on the 2nd August 2019 to 0.75%.

3.7.2 There have been continued uncertainties in the markets during the year to date as set out in the previous paragraphs of this report.

3.7.3 The strategy for 2018/19 continued the prudent approach and ensured that all investments were only to the highest quality rated banks and only up to a period of one year.

3.7.4 The table below sets out the average monthly rate received on our investments and compares it to the Bank of England Base rate to reflect the interest rates available in the market.

Month	Amount £	Monthly rate	Margin against Average Base rate %	Average balance in month £m
April	12,018	0.59%	+0.09%	24.8
May	12,798	0.65%	+0.15%	23.2
June	12,132	0.66%	+0.16%	22.4
July	13,284	0.67%	+0.17%	23.2
August	18,983	0.75%	+0.01%	29.8
September	19,226	0.82%	+0.07%	28.4
October	19,239	0.84%	+0.09%	26.9
November	19,185	0.87%	+0.12%	26.8
December	20,031	0.90%	+0.15%	26.3
January	20,464	0.93%	+0.18%	26.2
February	18,722	0.95%	+0.20%	25.6
March	20,186	0.96%	+0.21%	24.8
Total in 2018/19	206,450	0.80%	0.13%	25.7

3.7.5 The total amount received in short term interest for the year was £206,450 at an average rate of 0.80%. This was above the average base rates in the same period (0.67%) and reflects the Fire Authority's risk appetite ensuring, so far as possible in the financial climate, the security of principal and the minimisation of risk.

3.7.6 Throughout the year bank notice accounts and fixed term deposits with banks and other Local Authorities were used to invest core balances up to duration of 6 months. Instant access cash money market funds were used to hold liquidity balances to meet day to day creditor requirements. Interest earned by the main liquidity buckets are detailed below.

Investment Type	Liquidity Bucket	Interest Earned 2018/19 £
Money Market Fund	Instant Access	53,090
Notice Account	95 / 180 Day Notice	107,820
Fixed Term Deposits	6 Month Fixed	45,540
	Total in 2018/19	206,450

3.7.7 Further options to invest core balances in alternative investments such as pooled property funds and mixed asset funds are being investigated and modelled to calculate suitable amounts and durations.

3.8 Capital Financing Requirement and Minimum Revenue Provision Statement

The Fire Authority's Borrowing Need (the Capital Financing Requirement)

3.8.1 The prudential indicator is the Authority's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the underlying borrowing need.

3.8.2 The Fire Authority approved the CFR projections for 2017/18 in its Strategy approved in February 2017. These are in the original estimate below.

	2017/18 Actual £000	2018/19 Original Estimate £000	2018/19 Actual £000
Opening CFR	10,973	10,773	10,773
Closing CFR	10,773	10,773	10,773
Movement in CFR	(200)	-	-
Movement in CFR represented by:			
Net financing	239	431	431
MRP	(439)	(431)	(431)
Movement in year	(200)	-	-

3.8.3 The Fire Authority is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge called the Minimum Revenue Provision (MRP), although it is also allowed to undertake additional voluntary payments.

3.8.4 The Authority sets aside a Minimum Repayment Provision based on basic MRP of 4% each year to pay for past capital expenditure and to reduce its CFR. For any new borrowing the Asset Life Method will be used to calculate MRP.

4 Treasury Management Advisors

4.1 The Strategy for 2018/19 explained that the Fire Authority uses Link Asset Services as its treasury management consultant through the contract that exists with East Sussex County Council. A range of services have been provided including:

- a) Technical support on treasury matters, capital finance issues and advice on reporting;
- b) Economic and interest rate analysis;
- c) Debt services which includes advice on the timing of borrowing;
- d) Debt rescheduling advice surrounding the existing portfolio;
- e) Generic investment advice on interest rates, timing and investment instruments;
- f) Credit ratings from the three main credit rating agencies and other market information;
- g) Assistance with training on treasury matters.

4.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remained with the Authority. This service remains subject to regular review.

4.3 Link Asset Services is the largest provider of Treasury Management advice services to local authorities in the UK and they claim to be the market-leading treasury management service to their clients and better those offered by competitors. The advice will continue to be monitored regularly to ensure an excellent level of service provided to our authority.

5 Conclusion

5.1 The prime objective of Treasury Management is the effective management of risk and that its activities are undertaken in a prudent affordable and sustainable basis. This report confirms the Authority has continued to follow an extremely prudent approach with the main criteria of security and liquidity before yield. The current emphasis must be to continue to be able to react quickly if market conditions worsen.